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Valley Telephone Cooperative Copper Valley Telephone Valley Connections, LLC

Digital Video - Internet - Phone - Business Systems

ORIGINAL

April 3, 2012

Arizona Corporation Commission
Docket Control
1200 West Washington Street
Phoenix, AZ 85007

Arizona Corporation Commission

DOCKETED

APR - 4 2012

DOCKETED BY	<i>MW</i>
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RE: Audited Financial Statements for Valley Connections, LLC, Docket T-04169A-04-0816 Decision No: 68080

Director,

Please find attached the audited financial statements for Valley Connections, LLC, which are requested by Docket T-04169A-04-0816 Decision No: 68080 dated August 17, 2005.

If you need any further information feel free to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Troy Judd", written over a small, stylized graphic of a checkmark or arrow.

Troy Judd
C.O.O. - Finance & Regulatory
Valley Connections LLC
520-384-8935

Enclosure

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VALLEY CONNECTIONS, L.L.C.

WILCOX, ARIZONA

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

**VALLEY CONNECTIONS, L.L.C.
WILLCOX, ARIZONA**

**FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**

TABLE OF CONTENTS

	Page <u>No.</u>
Independent Auditors' Report	1
Financial Statements	
Balance Sheet	Exhibit A 2
Statement of Income (Loss)	Exhibit B 3
Statement of Changes in Members' Equity	Exhibit C 4
Statement of Cash Flows	Exhibit D 5
Notes to Financial Statements	6
Accompanying Information	
Independent Auditors' Report on Accompanying Information	12
Schedule of Telecommunications Plant	Schedule 1 13
Schedule of Accumulated Provision for Depreciation	Schedule 2 14
RUS Mortgage Notes	Schedule 3 15
Compliance and Internal Control Section	
Letter to Board of Directors Regarding RUS, 7 CFR, Part 1773, RUS Policies Concerning Audits of RUS Borrowers	16
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	19

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Valley Connections, L.L.C.
Willcox, Arizona

We have audited the accompanying balance sheet of Valley Connections, L.L.C. as of December 31, 2011 and 2010, and the related statements of income (loss), member's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Valley Connections, L.L.C. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 8, 2012, on our consideration of Valley Connections, L.L.C.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

March 8, 2012

VALLEY CONNECTIONS, L.L.C.

Exhibit A

**BALANCE SHEET
DECEMBER 31, 2011 AND 2010**

ASSETS

	December 31,	
	2011	2010
CURRENT ASSETS		
Cash in Bank	\$ 276,664	\$ 43,882
Cash - Construction Fund	175	175
Accounts Receivable (Less allowance of \$8,763 in 2011 and \$2,729 in 2010)	221,651	170,748
Materials and Supplies (At average unit cost)	795,955	897,006
Accounts Receivable - Affiliated Companies		739,086
Prepaid Expenses	136,321	136,497
	<u>\$ 1,430,766</u>	<u>\$ 1,987,394</u>
NONCURRENT ASSETS		
Deferred Federal and State Income Taxes	\$ 581,649	\$ 458,659
Investment in Affiliated Company	6,468	4,977
	<u>\$ 588,117</u>	<u>\$ 463,636</u>
PLANT, PROPERTY, AND EQUIPMENT		
Telecommunications Plant in Service	\$ 19,598,238	\$ 18,860,793
Plant Under Construction	159,657	47,739
	<u>\$ 19,757,895</u>	<u>\$ 18,908,532</u>
Less: Accumulated Provision for Depreciation and Amortization	7,969,666	6,797,933
	<u>\$ 11,788,229</u>	<u>\$ 12,110,599</u>
TOTAL ASSETS	<u>\$ 13,807,112</u>	<u>\$ 14,561,629</u>

LIABILITIES AND MEMBERS' EQUITY

CURRENT LIABILITIES		
Current Maturities of Long-Term Debt - RUS	\$ 179,439	\$ 191,003
Accounts Payable - Trade	159,099	149,423
Accounts Payable - Affiliated Companies	170,701	
Customer Deposits	4,450	5,175
Other Current and Accrued Liabilities	122,674	150,736
	<u>\$ 636,363</u>	<u>\$ 496,337</u>
LONG-TERM DEBT		
RUS Notes	\$ 3,003,706	\$ 3,553,551
MEMBERS' EQUITY		
Valley Telephone Cooperative, Inc.	\$ 10,167,043	\$ 10,511,741
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 13,807,112</u>	<u>\$ 14,561,629</u>

The accompanying notes are an integral part of these financial statements.

VALLEY CONNECTIONS, L.L.C.

Exhibit B

STATEMENT OF INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	December 31,	
	2011	2010
OPERATING REVENUES		
Sales and Service Revenues		
Video Services Revenue	\$ 551,853	\$ 457,102
Business Systems Revenue	269,414	538,379
Internet Revenue	1,997,184	1,969,036
Voice Mail Revenue	17,165	19,677
Pager Revenue	209	568
Cellular Agency Revenue	36,653	54,943
Uncollectible Operating Revenue	(84,500)	(77,100)
	<u>\$ 2,787,978</u>	<u>\$ 2,962,605</u>
Cost of Sales and Service Revenues		
Video Services	\$ 658,624	\$ 623,197
Business Systems	132,167	341,962
Internet	1,144,989	1,346,413
Voice Mail	11,885	13,283
Pager	103	165
Cellular	20,159	33,871
	<u>\$ 1,967,927</u>	<u>\$ 2,358,891</u>
Gross Profit From Sales and Service Revenues	\$ 820,051	\$ 603,714
Telecommunications Services		
Local Service	331,794	329,525
Network Access and Long Distance	2,145,892	2,031,074
Miscellaneous Telecommunications Revenue	77,160	59,213
Total Revenues and Gross Profit	<u>\$ 3,374,897</u>	<u>\$ 3,023,526</u>
OPERATING EXPENSES		
Plant Specific Operations	\$ 659,324	\$ 650,210
Plant Nonspecific Operations	720,097	759,734
Depreciation Expense	1,208,536	1,214,796
Customer Operations	991,863	980,061
Corporate Operations	554,643	575,529
	<u>\$ 4,134,463</u>	<u>\$ 4,180,330</u>
OPERATING LOSS	\$ (759,566)	\$ (1,156,804)
OPERATING TAXES	210,177	251,707
NET OPERATING LOSS BEFORE FIXED CHARGES	<u>\$ (969,743)</u>	<u>\$ (1,408,511)</u>
FIXED CHARGES		
Interest on Long-Term Debt	\$ 162,418	\$ 251,576
Other Interest Expense	266	387
Allowance for Funds Used During Construction	(3,802)	(6,072)
	<u>\$ 158,882</u>	<u>\$ 245,891</u>
NET OPERATING LOSS	<u>\$ (1,128,625)</u>	<u>\$ (1,654,402)</u>
NONOPERATING INCOME (EXPENSE)		
Interest and Dividends	\$ 22	\$ 37
Other Income (Expense)	3,169	61,829
	<u>\$ 3,191</u>	<u>\$ 61,866</u>
NET LOSS BEFORE INCOME TAXES	<u>\$ (1,125,434)</u>	<u>\$ (1,592,536)</u>
Income Tax Benefit - Current	\$ 257,746	\$ 933,842
Income Tax Benefit (Expense) - Deferred	122,990	(347,218)
	<u>\$ 380,736</u>	<u>\$ 586,624</u>
NET LOSS	<u>\$ (744,698)</u>	<u>\$ (1,005,912)</u>

The accompanying notes are an integral part of these financial statements.

VALLEY CONNECTIONS, L.L.C.

Exhibit C

STATEMENT OF CHANGES IN MEMBERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	<u>Total</u>
Balance - January 1, 2010	\$ 8,742,653
Contributions	2,775,000
Net Loss - 2010	<u>(1,005,912)</u>
Balance - December 31, 2010	\$ 10,511,741
Contributions	400,000
Net Loss - 2011	<u>(744,698)</u>
Balance - December 31, 2011	<u><u>\$ 10,167,043</u></u>

The accompanying notes are an integral part of these financial statements.

VALLEY CONNECTIONS, L.L.C.

Exhibit D

STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	December 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	\$ (744,698)	\$ (1,005,912)
Adjustment to Reconcile Net Loss to Net Cash Provided by Operating Activities		
Depreciation	1,218,717	1,291,436
Noncash Income from Affiliated Company	(1,491)	(3,168)
Accounts Receivable	(50,903)	61,784
Materials and Supplies	101,051	212,632
Prepaid and Other Current Assets	176	(60,302)
Deferred Charges		14,636
Deferred Federal and State Income Taxes	(122,990)	347,218
Accounts Payable and Other Current Liabilities	(19,111)	(140,402)
Accounts Receivable (Payable) - Affiliated Companies	909,787	(70,846)
Net Cash Provided by Operating Activities	\$ 1,290,538	\$ 647,076
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to Plant in Service	\$ (893,752)	\$ (831,117)
Excess Salvage Value over Removal Costs	(2,595)	(28,728)
Net Cash Used in Investing Activities	\$ (896,347)	\$ (859,845)
CASH FLOWS FROM FINANCING ACTIVITIES		
Members' Equity Contributions	\$ 400,000	\$ 2,775,000
Payments on RUS Long-Term Debt	(561,409)	(6,329,334)
Net Cash Used in Financing Activities	\$ (161,409)	\$ (3,554,334)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ 232,782	\$ (3,767,103)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	44,057	3,811,160
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 276,839	\$ 44,057
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest	\$ 162,418	\$ 251,576
Income Taxes	\$ 0	\$ 0

The accompanying notes are an integral part of these financial statements.

VALLEY CONNECTIONS, L.L.C.

NOTES TO FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Valley Connections, L.L.C. (the Company) is a wholly-owned subsidiary of Valley Telephone Cooperative, Inc. The Company was formed during 2005 for the purpose of providing local telecommunications services to designated geographical service areas. Operating divisions also include the business systems division, which includes the sale and installation of telephones and telephone equipment, the retail cellular agent division, and the internet operating division, which involves the provision of internet access and related services.

System of Accounts

The accounting records of the Company conform to the Uniform System of Accounts prescribed by the Federal Communications Commission for Class A telephone companies further modified for telephone borrowers of the Rural Utilities Service (RUS).

Telephone Revenues

Local and intrastate operating revenues related to the provision of telecommunications services are under the jurisdiction of the Arizona Corporation Commission.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers Cash in Bank and Cash – Construction Fund to be cash and cash equivalents.

Group Concentrations of Credit Risk

The Company's headquarters facility is located in Willcox, Arizona. The customers are generally located in the southeastern portion of the State of Arizona. The Company may require a deposit from its customers upon connection which is applied to unpaid bills in the event of default. The deposit is returned after a prompt payment history is established. As of December 31, 2011 and 2010, deposits on hand totaled \$4,450 and \$5,175, respectively.

The Company maintains cash balances in various financial institutions located in Southeast Arizona. At times during the year and at year end, deposit balances exceeded FDIC insured amounts.

Accounts Receivable/Payable – Affiliated Companies, Related Party Transactions

The accounts represent amounts due to/from the parent company Valley Telephone Cooperative, Inc. and from Copper Valley Telephone, Inc. and Valley Telecommunications Company, Inc. for operating costs incurred by these companies on behalf of the Company. It is the Company's practice to liquidate these intercompany accounts periodically.

Trade Accounts Receivable

In the normal course of business, the Company recognizes accounts receivable for telecommunications services provided and billed. The Company allows 45 days from the date of billing for payment to be received or the service is disconnected. No interest is accrued on delinquent balances. The Company provides an allowance for doubtful accounts to recognize the portion of the receivables considered uncollectible. The allowance is estimated based on an aging of the receivables.

VALLEY CONNECTIONS, L.L.C.

NOTES FINANCIAL STATEMENTS

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Assets Pledged

All assets are pledged as security for the long-term debt to RUS.

3. Telecommunications Plant in Service

Telecommunications Plant, Maintenance, and Depreciation

Telecommunications plant is stated at the original cost of construction which includes the cost of contracted services, direct labor, materials, allowance for funds used during construction (capitalized interest), and overhead items. Contributions from others toward construction are credited to the applicable plant accounts.

When property which represents a retirement unit is replaced or removed, the average cost of such property as determined from the continuing property records is credited to plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the removal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to cost of construction and plant specific operations.

The major classes of telecommunications plant in service and related accumulated depreciation as of December 31, 2011 and 2010 are as follows:

	Original Cost			Accumulated Depreciation	
	December 31,		Depreciation	December 31,	
	2011	2010	Rate	2011	2010
General Support Assets	\$ 3,413,601	\$ 3,352,199	4.0 - 33.0%	\$ 2,370,717	\$ 2,289,576
Central Office Assets	7,519,369	7,006,326	9.0 - 50.0%	3,691,007	2,949,168
Cable and Wire Facilities	8,665,268	8,502,268	4.0%	1,907,942	1,559,189
	<u>\$ 19,598,238</u>	<u>\$ 18,860,793</u>		<u>\$ 7,969,666</u>	<u>\$ 6,797,933</u>

The Company provides for depreciation on a straight-line basis at annual rates, which will amortize the property over its estimated useful life. Depreciation on these assets for the years ended December 31, 2011 and 2010 was \$1,218,717 and \$1,291,436, respectively of which \$10,181 and \$76,640 was transferred from affiliated companies.

VALLEY CONNECTIONS, L.L.C.

NOTES FINANCIAL STATEMENTS

4. RUS Mortgage Notes

Mortgage notes due to RUS are payable to the United States of America. The notes are for a 20-year period and mature in 2025. Following is a summary of the outstanding debt:

	December 31,	
	2011	2010
Note N001 - 4.56%	\$ 3,183,145	\$ 3,354,993
Note N007 - 4.88%		389,561
	\$ 3,183,145	\$ 3,744,554
Less: Current Maturities	179,439	191,003
	<u>\$ 3,003,706</u>	<u>\$ 3,553,551</u>

Estimated RUS long-term debt maturities for the next five years are as follows:

2012	\$ 179,439
2013	187,795
2014	196,540
2015	205,692
2016	215,270

5. Income Taxes

The Company is a single member limited liability company and considered a disregarded entity (i.e. division) of the parent company for federal and state income tax purposes. As such, the operations are included in the consolidated federal and state income tax returns filed by the parent company and other affiliates owned by the parent company. Accordingly, the Company records federal and state income tax expense or benefit. Current taxes are allocated to the Company based on taxable income (loss) and deferred taxes are allocated to the Company on a stand alone basis. Prior to the 2007 calendar year, however, the Company operated as a multi-member limited liability company taxed as a partnership. Accordingly, federal and state income tax expense or benefit were not reported by the Company but were reported directly by the respective members.

Any net operating losses incurred by the Company and not utilized on a consolidated basis are either carried back to offset prior taxable income or carried forward to offset future taxable income, depending on the taxing jurisdiction. Federal net operating losses may be carried back to offset prior taxable income for a period not exceeding two years. Federal net operating losses not carried back may be carried forward to offset future taxable income for a period not exceeding 20 years. The states of Arizona and New Mexico only provide for net operating losses to be carried forward for a period not exceeding five years. At December 31, 2011, the Company has been allocated federal net operating loss carryovers of \$4,232,431, which begin to expire in the year 2027. The Company also has been allocated Arizona and New Mexico net operating loss carryovers of \$6,760,108 and \$6,617,830, respectively, which begin to expire in the year 2011.

VALLEY CONNECTIONS, L.L.C.

NOTES FINANCIAL STATEMENTS

The Company follows the asset and liability method for accounting for income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary difference between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled.

Deferred income taxes result from transactions which enter into the determination of taxable income in different periods than recorded for financial reporting purposes. At December 31, 2011 and 2010, the Company's principal sources of deferred federal and state income taxes are due to (1) differences in depreciation on assets for tax purposes, (2) amortization of start up costs for tax purposes and (3) federal and state net operating loss carryovers. Based on available information, management believes that it is more likely than not that the federal deferred tax assets resulting from the net operating loss carryover will be utilized. However, due to the shorter carryover period for state net operating losses, management believes that it is more likely than not that the state deferred tax assets resulting from state net operating loss carryovers will not be utilized prior to such carryovers expiring. Therefore, a valuation allowance has been recorded for the respective state deferred tax assets at December 31, 2011. The valuation allowance is an estimate and decisions made by management in the near term may impact this valuation.

The components of the deferred tax asset (liability) recognized in the financial statements are as follows:

	December 31,	
	2011	2010
<u>Net Noncurrent Deferred Income Taxes</u>		
<u>Federal</u>		
Deferred Tax Asset	\$ 729,058	\$ 564,481
<u>State</u>		
Deferred State Tax Asset	\$ 443,364	\$ 369,613
Deferred State Tax Liabilities	(147,409)	(105,822)
	\$ 295,955	\$ 263,791
Less: Valuation Allowance	(443,364)	(369,613)
	\$ (147,409)	\$ (105,822)
Total Net Noncurrent Deferred Tax Asset	\$ 581,649	\$ 458,659

VALLEY CONNECTIONS, L.L.C.

NOTES FINANCIAL STATEMENTS

Income taxes are provided for tax effects of transactions reported in the financial statements and consist of taxes due plus deferred taxes related to the accelerated depreciation and net operating loss carryovers. The components of income tax benefit (expense) are as follows:

	December 31,	
	2011	2010
Federal		
Current Benefit	\$ 218,159	\$ 766,300
Deferred Benefit (Expense)	525,208	(420,124)
Deferred Benefit (Expense) of Operating Loss Carryovers	(360,631)	132,003
	<u>\$ 382,736</u>	<u>\$ 478,179</u>
State		
Current Benefit	\$ 39,587	\$ 167,542
Deferred Expense	(41,587)	(59,097)
Deferred Benefit of Operating Loss Carryovers	72,747	64,801
Deferred Expense - Change in Valuation Allowance	(72,747)	(64,801)
	<u>\$ (2,000)</u>	<u>\$ 108,445</u>
Total Provision for Federal and State Income Taxes	<u>\$ 380,736</u>	<u>\$ 586,624</u>

On January 1, 2009, the Company adopted the "uncertain tax positions" provisions of accounting principles generally accepted in the United States of America. The Company determined that it is more likely than not that its tax positions will be sustained upon examination by The Internal Revenue Service (IRS) or other State taxing authority, and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Company files income tax returns in the U.S. federal jurisdiction, and the states of Arizona and New Mexico. The Company is no longer subject to U.S. federal and state income tax examinations by federal taxing authorities for years before 2008, and state taxing authorities for years before 2007.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. There were no penalties or interest recognized during the years ended December 31, 2011 and 2010.

6. Employee Benefits

Pension Benefits

Pension benefits for substantially all employees of the Company are provided through the National Telecommunications Cooperative Association (NTCA) Retirement and Security Plan and Savings Plan. The Retirement and Security Plan is a defined benefit pension plan and the Savings Plan is a defined contribution pension plan. Both plans are exempt from federal income taxes under the Internal Revenue Code. Quarterly contributions are made to the Retirement and Security Plan and monthly contributions to the Savings Plan equal to the amounts accrued for pension expense. In the Retirement and Security Plan, which is a master multi-employer plan

-11-
VALLEY CONNECTIONS, L.L.C.

NOTES FINANCIAL STATEMENTS

available to all members of NTCA, the accumulated benefits and plan assets are not determined or allocated by individual employer. The pension cost for the years ended December 31, 2011 and 2010, was \$105,681 and \$106,023, respectively.

Post-retirement Benefits other than Pensions

The parent company Valley Telephone Cooperative, Inc. administers a post-retirement benefit plan providing medical insurance and other benefits for eligible employees. The total periodic post-retirement benefit cost resulting from the allocation of common (shared) employee time amounted to \$11,438 and \$10,539 for the years ended December 31, 2011 and 2010, respectively.

7. Litigation, Commitments, and Contingencies

There is no pending litigation against the Company which is expected to have a material effect on the financial statements.

8. Subsequent Events

The Company's management has evaluated subsequent events through March 8, 2012, the date which the financial statements were available for issue. There were no subsequent events identified that would require adjustment to, or disclosures in, the financial statements.

ACCOMPANYING INFORMATION

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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**INDEPENDENT AUDITORS' REPORT ON
ACCOMPANYING INFORMATION**

Board of Directors
Valley Connections, L.L.C.
Willcox, Arizona

Our report on our audits of the financial statements of Valley Connections, L.L.C. for the years ended December 31, 2011 and 2010, appears on page 1. That audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules of telecommunications plant, accumulated provision for depreciation, and RUS mortgage notes are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subject to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, is fairly stated in all material respect in relation to the financial statements taken as a whole.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

March 8, 2012

VALLEY CONNECTIONS, L.L.C.

Schedule 1

SCHEDULE OF TELECOMMUNICATIONS PLANT
FOR THE YEAR ENDED DECEMBER 31, 2011

	Balance 1/1/2011	Additions and Transfers	Retirements	Balance 12/31/2011
TELECOMMUNICATIONS PLANT IN SERVICE				
General Support Assets:				
Land	\$ 243,883	\$	\$	\$ 243,883
Leased Phone Systems	156,330	14,418	32,885	137,863
Other Work Equipment	8,510			8,510
Buildings	970,097	27,981		998,078
Furniture and Fixtures	31,815			31,815
Office Equipment	31,936	3,180		35,116
Computer - Server	494,597	32,954	2,051	525,500
Computer - Router	799,756	17,805		817,561
Wireless Internet Equipment	615,275			615,275
	<u>\$ 3,352,199</u>	<u>\$ 96,338</u>	<u>\$ 34,936</u>	<u>\$ 3,413,601</u>
Central Office Assets:				
Digital Electronic Switching	690,598	126,940		817,538
C.O.E. - Other	107,037			107,037
Radio Systems	413,589			413,589
Circuit Equipment	2,263,976	123,576	9,030	2,378,522
Head End Equipment	2,875,987	87,043		2,963,030
Set Top Boxes	655,139	184,514		839,653
	<u>\$ 7,006,326</u>	<u>\$ 522,073</u>	<u>\$ 9,030</u>	<u>\$ 7,519,369</u>
Cable and Wire Facilities				
Underground Cable - Fiber	2,799,486	148,076		2,947,562
Conduit Systems	5,702,782	15,347	423	5,717,706
	<u>\$ 8,502,268</u>	<u>\$ 163,423</u>	<u>\$ 423</u>	<u>\$ 8,665,268</u>
Total Plant in Service	\$ 18,860,793	\$ 781,834	\$ 44,389	\$ 19,598,238
Plant Under Construction	47,739	111,918		159,657
Total Telecommunications Plant	<u>\$ 18,908,532</u>	<u>\$ 893,752</u>	<u>\$ 44,389</u>	<u>\$ 19,757,895</u>

-14-
VALLEY CONNECTIONS, L.L.C.

Schedule 2

**SCHEDULE OF ACCUMULATED PROVISION FOR DEPRECIATION
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Balance 1/1/2011</u>	<u>Accruals and Transfers</u>	<u>Retirements</u>	<u>Balance 12/31/2011</u>
TELECOMMUNICATIONS PLANT IN SERVICE				
General Support Assets:				
Leased Phone Systems	\$ 152,574	\$ 3,190	\$ 30,784	\$ 124,980
Other Work Equipment	7,234	1,277		8,511
Buildings	270,875	40,119		310,994
Furniture and Fixtures	31,814			31,814
Office Equipment	15,391	6,864		22,255
Computer - Server	494,596	602	2,051	493,147
Computer - Router	735,323	37,727		773,050
Wireless Internet Equipment	581,769	24,197		605,966
	<u>\$ 2,289,576</u>	<u>\$ 113,976</u>	<u>\$ 32,835</u>	<u>\$ 2,370,717</u>
Central Office Assets:				
Digital Electronic Switching	239,793	62,811		302,604
C.O.E. - Other	107,036			107,036
Radio Systems	389,860	23,730		413,590
Circuit Equipment	813,011	209,132	13,726	1,008,417
Head End Equipment	938,445	261,696		1,200,141
Set Top Boxes	461,023	198,196		659,219
	<u>\$ 2,949,168</u>	<u>\$ 755,565</u>	<u>\$ 13,726</u>	<u>\$ 3,691,007</u>
Cable and Wire Facilities:				
Underground Cable - Fiber	495,143	120,780		615,923
Conduit Systems	1,064,046	228,396	423	1,292,019
	<u>\$ 1,559,189</u>	<u>\$ 349,176</u>	<u>\$ 423</u>	<u>\$ 1,907,942</u>
Telecommunications Plant in Service	<u>\$ 6,797,933</u>	<u>\$ 1,218,717</u>	<u>\$ 46,984</u>	<u>\$ 7,969,666</u>
		(1)	(2)	
(1) Charged to Depreciation/Amortization Expense		\$ 1,208,536		
Transferred from Affiliates		10,181		
		<u>\$ 1,218,717</u>		
(2) Original Cost of Plant Retired			\$ 44,389	
Less: Salvage and Other Credits			2,595	
Loss Due to Retirement			<u>\$ 46,984</u>	

VALLEY CONNECTIONS, L.L.C.

Schedule 3

**RUS MORTGAGE NOTES
FOR THE YEAR ENDED DECEMBER 31, 2011**

RUS

<u>Note</u>	<u>Date of Note</u>	<u>Interest Rate</u>	<u>Principal Amount</u>	<u>Amount Unadvanced</u>	<u>Principal Payments</u>	<u>Net Obligation</u>
N001	3-21-05	4.56%	\$ 3,969,841	\$	\$ 786,696	\$ 3,183,145
N007	3-21-05	4.88%	<u>452,280</u>	<u></u>	<u>452,280</u>	<u>-</u>
			<u>\$ 4,422,121</u>	<u>\$ 0</u>	<u>\$ 1,238,976</u>	<u>\$ 3,183,145</u>

Net obligation includes \$179,439 payable within one year and is classified as a current portion on the balance sheet.

COMPLIANCE AND INTERNAL CONTROL

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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**LETTER TO BOARD OF DIRECTORS REGARDING RUS, 7 CFR, PART 1773,
RUS POLICIES CONCERNING AUDITS OF RUS BORROWERS**

Board of Directors
Valley Connections, L.L.C.
Willcox, Arizona

We have audited the financial statements of Valley Connections, L.L.C. for the year ended December 31, 2011, and have issued our report thereon dated March 8, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and 7 CFR Part 1773, Policy on Audits of Rural Utilities Service (RUS) Borrowers. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Valley Connections, L.L.C. for the year ended December 31, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered their internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of their internal control. Accordingly, we do not express an opinion on the effectiveness of their internal control.

Our consideration of the internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. A material weakness is a significant deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses.

7 CFR Part 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.33 (e)(2), and related party transactions and investments. In addition, our audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports (other than our independent auditors' report and our independent auditors' report on compliance and on internal control over financial reporting, all dated March 8, 2012) or summary of recommendations related to our audit have been furnished to management.

Our comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR Part 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted no matters regarding Valley Connections, L.L.C.'s internal control over financial reporting and its operation that we consider to be a material weakness as previously defined with respect to:

- the accounting procedures and records;
- the process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts, and,
- the materials control.

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts, and grants. The procedures we performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract, agreement, or lease between the borrower and an affiliate for the year ended December 31, 2011 of Valley Connections, L.L.C.:
 - Obtained and read a borrower-prepared schedule of new written contracts, agreements, or leases entered into during the year between the borrower and an affiliate as defined in §1773.33(e)(2)(i).
 - Reviewed Board of Director Minutes to ascertain whether board-approved written contracts are included in the borrower-prepared schedule.
 - Noted the existence of written RUS approval of each contract listed by the borrower.
- Procedure performed with respect to the requirement to submit RUS Form 479 to the RUS:
 - Agreed amounts reported in Form 479 to Valley Connections, L.L.C.'s records.

The results of our tests indicate that, with respect to the items tested, Valley Connections, L.L.C. complied, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS to enter into any contract, agreement, or lease with an affiliate as defined in §1773.33(e)(2)(i); and
- The borrower will allow us to review the Form 479, Financial and Statistical Report, as of December 31, 2011, prior to its submission to RUS.

COMMENTS ON OTHER ADDITIONAL MATTERS

In connection with our audit of the financial statements of Valley Connections, L.L.C., nothing came to our attention that caused us to believe that Valley Connections, L.L.C. failed to comply with respect to:

- The reconciliation of continuing property records to the controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);
- The clearing of construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR Parts 1773.33(c)(3) and (4);
- The approval of the sale, lease or transfer of capital assets and disposition of proceeds of the sale of plant, material, or scrap, addressed at 7 CFR Part 1773.33(c)(5);
- The disclosure of material related party transactions, in accordance with Accounting Standards Codification 850, *Related Party Transactions*, for the year ended December 31, 2011, in the financial statements referenced in the first paragraph of this report addressed at 7 CFR Part 1773.33 (f); and
- The detailed schedule of investments.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The detailed schedule of investments in affiliated companies required by 7 CFR 1733.33 (i) provided below is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Investment in Affiliated Companies consist of:

N/A

This report is intended solely for the information and use of the Board of Directors, management, RUS, and supplemental lenders, and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

March 8, 2012

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Valley Connections, L.L.C.
Willcox, Arizona

We have audited the financial statements of Valley Connections, L.L.C. as of and for the year ended December 31, 2011, and have issued our report thereon dated March 8, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Valley Connections L.L.C.'s internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Valley Connections, L.L.C.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Directors, management, and the Rural Utilities Services, and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

March 8, 2012

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

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March 8, 2012

Board of Directors
Valley Connections, L.L.C.
Willcox, Arizona

We have audited the financial statements of Valley Connections, L.L.C. for the year ended December 31, 2011, and have issued our report thereon dated March 8, 2012. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated July 21, 2011, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of Valley Connections, L.L.C. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters. Our audit of the financial statements does not relieve you or management of your responsibilities.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the entity's financial statements and report does not extend beyond the financial information identified in the report, in addition we do not have an obligation to perform any procedures to corroborate other information contained in these documents.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter and meetings about planning matters.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. No new accounting policies were adopted and the application of existing policies was not changed during December 31, 2011. We noted no transactions entered into by the Company during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were estimating the useful life of plant, property, and equipment and Management's estimates used in determining deferred income tax assets and liabilities. Management's estimate of the useful life of property, plant and equipment is based on industry standard depreciation rates. We evaluated the key factors and assumptions used to develop the estimated useful life of plant, property, and equipment in determining that it is reasonable in relation to the financial statements taken as a whole. Management's estimates used in determining deferred income tax assets and liabilities were based on tax temporary tax timing differences measured at the tax rate expected to be in effect when the differences are recognized on the tax return. We evaluated the related deferred tax asset and liability in relation to the differences between book and tax return net income, and the effective tax rate on the tax return to determine the amounts are reasonable.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements were the Telecommunications Plant in Service as disclosed in Note 3, RUS Mortgage Notes as disclosed in Note 4, and Income Taxes as disclosed in Note 5.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. Attached are the adjustments that were made by management as a part of our audit.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 8, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Company's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Company's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of Board of Directors and management of Valley Connections, L.L.C. and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Balinger, Segars, Gilbert & Mass LLP

Certified Public Accountants